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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 14, 1930

CERTIORARI GRANTED OCTOBER 20, 1930

(35,273)

(35,273)

SUPREME COURT OF THE UNITED STATES

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No. 351

A. JAMES ECKERT, PETITIONER,

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 22, 1930

[fol. a-1]

BEFORE U. S. BOARD OF TAX APPEALS

Docket No. 29656

A. James Eckert, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

For Taxpayer: Henry T. Dorrance, Esq.
For Commissioner: Hartford Allen, Esq., and Hugh Brewster, Esq.

Docket Entries

1927.

July 14. Petition received and filed. Taxpayer notified.
" 15. Copy of Petition served on General Counsel. (Fee Paid.)
Aug. 18. Answer filed by General Counsel.
" 20. Copy of answer served on taxpayer. General Calendar.

1929.

Feb. 12. Hearing set March 28, 1929.
Mar. 20. Notice substituting Henry T. Dorrance for C. R. Dewey, attorney for taxpayer filed.
" 28. Hearing had before Mr. Arundell on merits. Submitted. Briefs due 4-30-29. No exchange.
Apr. 10. Transcript of hearing 3-28-29 filed.
" 26. Brief filed by taxpayer.
" 29. Brief filed by General Counsel.

[fol. 2]

Sept. 17. Findings of fact and opinion rendered. C. Rogers Arundell, Div. 7. Judgment will be entered for respondent.
" 20. Decision entered. C. Rogers Arundell, Div. 7.
Oct. 9. Supersedeas bond for $6,757.78 approved and filed.

1930.

Jan. 13. Petition for review to U. S. Circuit Court of Appeals, 2nd Circuit with assignments of error, filed by taxpayer (1).

Jan. 21. Proof of service filed.
" 16. Præcipe filed by taxpayer.
" 24. Proof of service filed.

Now, February 13, 1930, the foregoing Docket Entries certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed July 14, 1927

The petition of A. James Eckert respectfully shows:

I. The petitioner is an individual with residence on Paris Road in the Village of New Hartford, County of Oneida and State of New York.

II. The Commissioner of Internal Revenue has determined that there is a deficiency in respect of income tax imposed against the petitioner by the Revenue Act of 1924, notice of such deficiency having been issued to petitioner by letter dated, registered and mailed to petitioner on June 4, 1927, a copy of which deficiency letter and notice bearing symbol number IT:PA:3:60D:RMH is hereto annexed and made a part hereof.

III. The amount of the deficiency, the nature of the tax, the year for which asserted and the amount thereof (as [fol. 4] nearly as may be determined) in controversy is as follows:

(a) The amount of the deficiency is $3,378.89.

(b) The tax is income tax.

(c) The year for which the tax is asserted is the year 1925.

(d) The amount of the deficiency in controversy is the entire amount of the deficiency assessed—$3,378.89.

IV. The following error is alleged to have been commited by the Commissioner:

The Commissioner erred in disallowing as a deduction from income for the taxable period, as a bad debt, the sum of $22,400.00, representing indebtedness of the Electric Refrigerator Co., Inc., to the petitioner in that amount.

V. The facts on which the petitioner relies as sustaining the aforesaid assignment of error are as follows:

Prior to 1922 the petitioner and one William A. Ainsworth had been engaged in a partnership under the name of the Electric Refrigerating Company.

In 1922 a corporation was organized under the name of The Electric Refrigeration Co., Inc., taking over the assets of the partnership and assuming all its liabilities among which were notes in the amount of $25,419.65. Thereafter and in the course of its business the corporation made and [fol. 5] issued additional notes payable in the amount of $19,375.25. All of these notes were either endorsed or guaranteed by the petitioner and the said William A. Ainsworth.

In 1925 the business of the corporation was discontinued, it being found on the dissolution that there were practically no assets and that the corporation was totally unable to pay off any of the aforesaid notes in the amount of $25,419.65 assumed by it, or the $19,375.25 made by it, all of which notes were either endorsed or guaranteed by the petitioner and William A. Ainsworth, personally.

The bank holding the notes called the same and the petitioner and William A. Ainsworth were obliged to pay the entire amount. This they did by borrowing from the bank the sum of $44,800.00, giving their personal notes therefor, whereupon the old notes were marked paid and surrendered. No payments have been or will be received by the petitioner or by Mr. Ainsworth from the corporation by way of reimbursement.

The petitioner claimed his one-half of the total amount paid by him and Mr. Ainsworth as a proper deduction for the year 1925, writing the same off as a bad debt in the amount of $22,400.00.

Wherefore petitioner respectfully prays for the redetermination by this Board of the deficiency in respect of the

[fol. 6] tax assessed by the Commissioner as aforesaid, and for such other and further relief as may be just and proper.

Dated Utica, N. Y., July 12th, 1927.

C. R. Dewey, Counsel for Petitioner. Office & P. O. Address: First National Bank Bldg., Utica, New York.

Duly sworn to by A. James Eckert. Jurat omitted in printing.

[fol. 7] Treasury Department, Washington

Office of Commissioner of Internal Revenue

IT:PA:3:60D. RMH.

June 4, 1927.

Mr. A. James Eckert, Paris Road, New Hartford, New York.

SIR: The determination of your income tax liability for the years 1924 and 1925, as set forth in office letter dated April 13, 1927, disclosed a deficiency in tax amounting to $3,378.89, for the year 1925. The adjustments made are shown in the attached statement.

In accordance with the provision of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals [fol. 8] and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Ap-

peals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA:3:60:RMH. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully, D. H. Blair, Commissioner, by C. R. Nash, Assistant to the Commissioner.

Inclosures: Statement, Form A, Form 882.

[fol. 9] Statement

IT:PA:3:60D. RMH.

June 4, 1927.

In re Mr. A. James Eckert, Paris Road, New Hartford, New York.

Year	Deficiency in tax
1924	None
1925	$3,378.89
Total	$3,378.89

The report of the Internal Revenue Agent in Charge at Buffalo, New York, transmitted to this office under date of March 30, 1927, has been reviewed and approved.

The information submitted at the conference in this office on May 6, 1927, relative to the disallowance of the deduction of $22,800.00 for bad debts has been carefully considered. The letter dated May 20, 1927, from the Citizens Trust Company of Utica, New York, has also been considered. The agent disallowed the deduction on the grounds that no cash was paid by you and that your individual notes were given to replace the old notes of the partnership and the corporation on which you were an endorser. Inasmuch as you reported income on the cash receipts and disbursements basis the revenue agent is correct. Your protest is accordingly denied. This procedure is in accordance with A. R. M. 201, Cumulative Bulletin II-1, Page 86.

[fol. 10] Payment of the tax in question should not be made until a bill is received from the Collector of Internal

Revenue for your district, and remittance should then be made to him.

Now, February 13, 1930, the foregoing Petition certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed Aug. 18, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

[fol. 11] 1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3.

4. Denies that any error has been committed in the determination of the deficiency.

5. The allegations contained in paragraph 5 on page 2 of the petition are admitted.

The allegations contained in the first paragraph on page 3 of the petition are denied for lack of sufficient information to form a belief.

Denies generally and specifically each and every allegation in taxpayer's petition contained not hereinbefore admitted, qualified or denied.

Wherefore, having fully answered the petition of the above-named taxpayer, the respondent prays that his appeal be denied.

A. W. Gregg, General Counsel, Bureau of Internal Revenue. Of Counsel: Henry Ravenel, Hugh Brewster, Special Attorneys, Bureau of Internal Revenue.

Now, February 13, 1930, the foregoing Answer certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 12] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 29656

A. JAMES ECKERT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Promulgated September 17, 1929

FINDINGS OF FACT AND OPINION

The amount of a note given by the petitioner in settlement of his liability as an indorser of a note is not deductible from gross income, he being on the cash receipts and disbursements basis and no cash having been paid on the note during the taxable year.

Henry T. Dorrance, Esq., for the Petitioner.
Hartford Allen, Esq., and Hugh Brewster, Esq., for the Respondent.

This proceeding was instituted to redetermine a deficiency of $3,378.89 in income tax for the year 1925. The question in controversy is whether the sum of $22,400, representing one-half of the amount of a note given by the petitioner and another individual in payment of their liability as indorsers of a note, is deductible from gross income as a loss or a bad debt.

[fol. 13] Findings of Fact

Prior to 1922 the petitioner and William A. Ainsworth were engaged in business as partners under the firm name of Electric Refrigeration Company. In 1922 they organized a corporation under the name of Electric Refrigeration Co., Inc., which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, N. Y., for money loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several addi-

tional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid balance of $44,800, after charging about $5 to the personal account of the petitioner. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank, their joint note for $44,800 in settlement of their liability as indorsers of the corporation's [fol. 14] notes and in return received the corporation's notes stamped "paid." The notes were subsequently destroyed by the petitioner.

The liquidation of his liability as an indorser of the corporation's note did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of account. His return for the taxable year was filed on the basis of cash received and disbursed.

In his determination of the deficiency in controversy, the respondent declined to allow any amount of the note as a deduction from gross income on the ground that no cash payments were made on the notes during the taxable year.

Opinion

ARUNDELL: The position of the petitioner is that by reason of the fact that he was compelled to make good his liability as an indorser of the corporation's notes, he is entited to a deduction of $22,400 (one-half of the amount of the note given by the petitioner and Ainsworth), even though the note was not paid by cash. The respondent contends on the other hand that the amount is not deductible either as a loss sustained or a bad debt since the petitioner did not during the taxable year disburse any cash or its equivalent in property. The facts are not in dispute.

Section 212 of the Revenue Act of 1924 provides:

[fol. 15] (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of thetaxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer * * *.

Section 214 (a) of the same Act provides that in computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(7) Debts ascertained to be worthless and charged off within the taxable year * * *.

In Jackson County State Bank, 2 B. T. A. 1100, we said: "The expression 'losses sustained' means actual losses and not paper losses." To be entitled to a deduction for a loss, a taxpayer "must prove as a fact that it was actually sustained within the year". Carl Muller, 4 B. T. A. 169. In E-ectric Reduction Co. v. Lewellyn, 11 Fed. (2d) 493 (Reversed 275 U. S. 243 on other grounds) the following appears:

"Failure to keep that which one has is a loss. Foehren-[fol. 16] bach v. German-American Title & Trust Co., 66 A. 561, 217 Pa. 332, 12 L. R. A. (N. S.) 465, 118 Am. St. Rep. 916. There are many kinds of loss: Money out of pocket; a judgment, changing the status from solvency to insolvency. Schambs v. Fidelity & Casualty Co., 259 F. 55, 58, 170 C. C. A. 55, 6 A. L. R. 1231."

The petitioner in the case of Morris Sass, 12 B. T. A. 156, claimed the right to deduct as a loss the amount of a note he gave a bank in satisfaction of his contract of guaranty on a number of loans, he being on the cash basis in the year in which the instrument was executed. In sus-

taining the Commissioner's action disallowing the sum of the note as a deduction, we said:

"The giving of a note does not constitute a disbursement or deprivation of cash, nor does it necessarily constitute a disbursement of the equivalent thereof. In giving his note to the bank, petitioner gave evidence of his indebtedness in the amount of $19,253.54 incurred as a guarantor, but being on the cash receipts and disbursements basis he did not sustain an actual and deductible loss, i. e., a deprivation of his property, until he paid the note subsequent to 1919."

An identical situation exists here. The petitioner did not at any time during the taxable year pay out any cash or its equivalent in property in satisfaction of his liability to the holder of the corporation's notes. He merely exchanged his note under which he was primarily liable for [fol. 17] the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value. Not having paid out anything either prior to or during the taxable year, the petitioner had no investment to lose or to charge off as valueless. His cash assets were not diminished in any amount by the giving of the note. In our opinion the petitioner is not entitled to a deduction of the amount claimed either as a loss or as a worthless debt of the corporation. See Morris Sass, supra, and Morris Sass, 17 B. T. A. —, Promulgated September 17, 1929.

Reviewed by the Board.

Judgment will be entered for the respondent.

Smith dissents.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

Now, February 13, 1930, the foregoing Findings of Fact and Opinion certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

(Seal.)

[fol. 18] BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 29656

A. JAMES ECKERT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Board's findings of fact and opinion, promulgated September 17, 1929, it is

Ordered and Decided: That there is a deficiency of $3,378.89 for the year 1925.

Enter.

(Signed) C. Rogers Arundell, Member United States Board of Tax Appeals.

Entered Sept. 20, 1929.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

[fol. 19] Now, February 13, 1930, the foregoing Decision certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

A. JAMES ECKERT, Petitioner-Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW—Filed Jan. 13, 1930

To the Circuit Court of Appeals for the Second Circuit:

The petition of A. James Eckert respectfully shows:

[fol. 20] 1. This is a proceeding for the review by the U. S. Circuit Court of Appeals for the Second Circuit of a

decision of the U. S. Board of Tax Appeals entered on September 20th, 1929, ordering and deciding that there is a deficiency in income tax for the year 1925 against the petitioner in the amount of $3,378.89.

2. Your petitioner is a resident of the Village of New Hartford, County of Oneida and State of New York.

3. The nature of the controversy before the Board of Tax Appeals was the determination of income taxes for the year 1925 involving the disallowance by the Commissioner of the sum of $22,400.00 claimed by the taxpayer as a deduction from income as a bad debt or business loss for the year 1925.

The claim of the taxpayer arises from undisputed facts that are summarized in the Findings of the Board as follows:

"Prior to 1922 the petitioner and William A. Ainsworth were engaged in a business as partners under the firm name of Electric Refrigeration Company. In 1922 they organized a corporation under the name of Electric Refrigeration Co., Inc., which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, N. Y., for money [fol. 21] loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several additional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently, in 1925, the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid balance of $44,800., after charging about $5 to the personal account of the petitioner. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank, their joint note for $44,800 in settle-

ment of their liability as indorsers of the corporation's notes and in return received the corporation's notes stamped "paid". The notes were subsequently destroyed by the petitioner.

The liquidiation of his liability as an indorser of the corporation's note did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of [fol. 22] account. His return for the taxable year was filed on the basis of cash received and disbursed."

4. The error committed by the Board of Tax Appeals upon which the petitioner relies upon as the basis of the proceeding is as follows:

(a) The Board erred in disallowing as a deduction from income for the taxable period as a bad debt or business loss, the sum of $22,400.00 representing notes and indebtedness of the Electric Refrigeration Co., Inc., to the petitioner in that amount which were acquired by the petitioner and were ascertained to be worthless in 1925 and deducted for that year.

(b) The Board erred in basing its decision on the ground that notes and not cash were paid in 1925 by the petitioner, disregarding the fact that the petitioner is here claiming a bad debt deduction on the notes of the Electric Refrigeration Co., Inc., acquired as aforesaid, and not a business loss represented by the new personal notes which were given.

Wherefore your petitioner prays that this court may review the action of the Board of Tax Appeals in this cause, reverse the decision of the Board, and direct the entry of a decision by said Board in favor of the petitioner, determining that there is no deficiency in income tax for the year 1925 due from the petitioner and for such other [fol. 23] and further relief as to this court may appear proper in the premises.

(Sgd.) Henry T. Dorrance, Attorney for Petitioner-Appellant. Office and Post Office address: 1015-1025 First National Bank Bldg., Utica, N. Y.

Duly sworn to by A. James Eckert. Jurat omitted in printing.

Now, February 13, 1930, the foregoing Petition for Review certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 24] In United States Circuit Court of Appeals

[Title omitted]

Præcipe for Transcript of Record—Filed Jan. 16, 1930

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of the record in this cause and on or before March 13th, 1930, transmit the same to the Clerk of the U. S. Circuit Court of Appeals for the Second Circuit and include in said transcript copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the Board in the above entitled cause.
2. Petition for Redetermination filed July 14th, 1927.
3. Answer to Petition filed August 18th, 1927.

[fol. 25] 4. Findings of Fact and Opinion of the Board promulgated September 17th, 1929.

5. Order and Decision entered September 20th, 1929.
6. Petition for Review filed January 13th, 1930.

Said transcript to be prepared as required by law and the rules of the U. S. Circuit Court of Appeals for the Second Circuit.

Henry T. Dorrance, Attorney for Petitioner-Appellant. Office and Post Office address: 1015-1025 First National Bank Bldg., Utica, N. Y.

Now, February 13, 1930 the foregoing Præcipe for Transcript certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 26] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1929

No. 333

Argued May 6, 1930. Decided June 2, 1930

A. JAMES ECKERT, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

Before Manton, Swan, and Augustus N. Hand, Circuit Judges

Petition to review an order of the Board of Tax Appeals which determined a deficiency in the taxpayer's return for the year 1925. The taxpayer appeals. Order affirmed.

Dunmore, Ferris & Dewey, of Utica, N. Y. (Henry T. Dorrance, of Utica, N. Y., of counsel), for petitioner.

G. A. Youngquist, Asst. Atty. Gen., J. Louis Monarch and Helen R. Carloss, Sp. Assts. to Atty. Gen. (C. M. Charest, Gen. Counsel, Bureau of Internal Revenue, of Washington, D. C., and Dewitt M. Evans, Sp. Atty., Bureau of Internal Revenue, of Washington, D. C., of counsel), for respondent.

OPINION

MANTON, Circuit Judge:

The petitioner was engaged in business, prior to 1922, with a partner, under the firm name of Electric Refrigerator Company. In 1922 they incorporated the business under the name of Electric Refrigerator Company, Inc., which acquired the assets and assumed the liabilities of the partnership, including promissory notes of $25,419.65 payable to a bank for money loaned to the partnership. The bank accepted notes executed by the corporation for the partnership notes and later several additional notes for money loaned, amounting to $19,375.25, were given to the bank. All the notes issued by the corporation in favor of

the bank were indorsed by the petitioner and his former partner.

In September, 1925, the bank demanded payment, and subsequently the corporation discontinued business and was dissolved; its assets being insufficient to pay the amount due on the notes in excess of $600. This left a balance of $44,800, for which the petitioner and his partner delivered to the bank a joint note of $44,800 in settlement of this liability as indorsers of the corporation's notes and in return received the corporation notes marked "Paid." The notes thus given were not paid in 1925, and there was no cash transaction in connection with the making and delivery of the notes.

The petitioner filed his return for the year in question on the basis of cash received and disbursed. The respondent declined to allow any amount of the note as a deduction from gross income, for the reason that no cash payments had been made on the notes during the taxable year. The Board of Tax Appeals affirmed this ruling.

A taxpayer keeping his books or doing business on a cash received and disbursed basis can only deduct items actually paid in cash during the year. The Revenue Act of 1924, § 212 (43 Stat. 267, 26 USCA § 953) provides: "(a) In the case of an individual the term 'net income' means the gross income as defined in section 954 of this title, less the deductions allowed by sections 937 and 955. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of [fol. 27] such taxpayer." Section 214(a) of the same act (26 USCA § 955) provides that in computing net income there shall be allowed as deductions: "(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business; * * * (7) Debts ascertained to be worthless and charged off within the taxable year. * * *"

It is essential that the taxpayer make his return on a basis that clearly reflects the true net income, and to that end the Commissioner has properly recognized two systems of accounting—(a) accrual system and cash accrual; and (b) cash receipts and disbursements. Under the accrual method, the taxpayer returns as income all items of income

receivable, whether actually received or not, and deducts items of expense for which liability is incurred whether he has actually paid them or not. But, when his method is on a cash receipt and disbursement basis, he need only report income received in cash, and is allowed to deduct items of expense actually paid or losses actually sustained. The taxpayer may not employ one method in accounting for income derived and the other in making the authorized deductions for the purpose of ascertaining his net income which is subject to taxation. American Nat. Co. v. United States (1927) 274 U. S. 99, 47 S. Ct. 520, 71 L. Ed. 946; United States v. Mitchell (1926) 271 U. S. 9, 46 S. Ct. 418, 70 L. Ed. 799; United States v. Anderson (1926) 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347. While here the petitioner says he kept no books. Still, in filing his return, he indicated a cash receipt and disbursement basis, and the Commissioner was authorized to require him to account for the loss of the transaction here involved in a manner consistent with the cash receipt and disbursement method of accounting.

On this basis, petitioner did not lose by reason of his indorsement or assumption of a corporation's obligation to the bank by issuing his own note. His liability on the corporation's note arose by reason of the indorsement, and, when he sustains a loss, it must be attributable to that alone. That loss will be realized and may be recognized when payment of the note or part thereof is made in cash. Osterloh v. Lucas (1930) 37 F. (2d) 277 (C. C. A. 9). The giving of a note does not constitute a cash payment. The obligation to pay the amount of the note may be as binding, for instance, as payment of taxes, but it has been determined that a taxpayer on a cash received and disbursed basis cannot deduct taxes before they are actually paid. United States v. Mitchell, supra. Nor can a taxpayer who subscribes to a charitable fund, deduct the subscription until he has paid it. Mann v. Commissioner (App. D. C. 1929) 35 F. (2d) 873. The taxpayer not having sustained a loss because he did not pay the note or any part thereof in the year 1925, the Commissioner properly held that he was not entitled to this deduction. Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it.

Order affirmed.

[fol. 28] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

A. JAMES ECKERT, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

JUDGMENT—Filed June 9, 1930

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fols. 29 & 29½] [File endorsement omitted.]

[fols. 30-35] Petition for rehearing, covering six pages, omitted from this print. It was denied and nothing more by order July 3, 1930.

[fol. 36] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals in and for the Second Circuit, held at the courtrooms, in the Post Office building, in the city of New York, on the 3rd day of July, one thousand nine hundred and thirty.

[Title omitted]

ORDER DENYING REHEARING—Filed July 7, 1930

A petition for a rehearing having been filed herein by counsel for the petitioner;

Upon consideration thereof it is
Ordered that said petition be and hereby is denied.
Wm. Parkin, Clerk.

[fol. 37] [File endorsement omitted.]

[fol. 38] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 39] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 20, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 35,273. U. S. Circuit Court of Appeals, Second Circuit. Term No. 351. A. James Eckert, petitioner, vs. Commissioner of Internal Revenue. Petition for writ of certiorari and exhibit thereto. Filed August 14, 1930. File No. 35,273.